SCAN-24.DOC

Picking losers in Japan

Many aspects of the Japanese economy cause controversy among western economists—but nearly everybody agrees that the country's industrial policy has been a success. Has it?

ECONOMICS FOCUS

IT IS an article of faith in Washington, DC, these days that Japan's use of industrial policy sets an example that America ought to follow. In the United States, unlike Europe and Japan, governments have tended not to rely on ambitious industrial strategies. Europe's approach is hardly to be emulated, you might think; but Japan's is. For the distinctive feature of industrial policy in Japan, it is argued, is that it was clever. Somehow, bureaucrats there have avoided the pitfalls encountered in many other countries: they have picked and supported winners, not losers.

Laura Tyson, now chairman of Bill Clinton's Council of Economic Advisers, wrote in 1990 (along with two co-authors) that "a key feature of Japan's development strategy is the targeting of industries on the basis of their perceived potential for economic growth and technological change." Perhaps this did not always work—witness Japan's problems with high-definition television (see page 65)—but, judging by Japan's growth over the past 40 years, it has succeeded often enough.

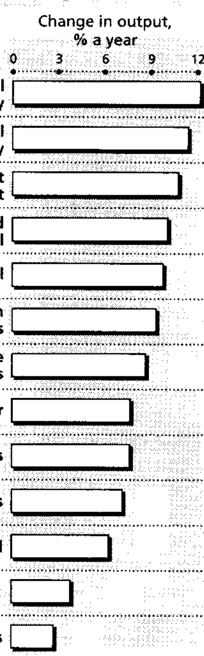
A new study by Richard Beason of the University of Alberta and David Weinstein of Harvard University suggests otherwise*. Much of the support for the conventional view is anecdotal. And research on the subject, such as it is, has looked at particular industries, rather than at one industry compared with another. In Japan, as elsewhere, almost every industry has benefited from some sort of subsidy or protection. The question is whether the industries that received the lion's share of preference were winners or losers.

For each of 13 sectors, between 1955 and 1990, the authors consider four sorts of industrial policy. They rank the sectors, from one to 13, according to the degree of support received under each policy (one means most assisted and 13 least). These rankings are then compared with the sectors' growth rates. The question is whether the most-helped sectors grew fastest—in other words, did Japan pick winners?

The four tools of industrial policy are:

• **Cheap loans.** The authors add up lending from the state-run Japan Development Bank, and express this as a proportion of all loans to each sector. This gives the share of subsidised borrowing. Mining is ranked first: 16% of loans to that sector were subsidised. Precision instruments are ranked 13th, with a subsidised share of less than 1%.

Growth and protection, 1955-90



	Cheap loans	Net transfers	Trade protection	Tax relief
Electrical machinery	8	9	8	8
General machinery	12	4	11	8
Transport equipment	7	11	4	8
Fabricated metal	10	6	12	7
Oil and coal	2	13	7	3
Precision instruments	13	10	6	8
Ceramics, stone and glass	5	8	9	3
Pulp and paper	6	5	10	13
Chemicals	3	7	5	3
Basic metals	4	2	3	6
Processed food	9	12	1	12
Mining	1	1	13	1
Textiles	11	3	2	2

Ranking*

Source: Beason and Weinstein

* 1=most subsidised

• **Net transfers.** Broadly, this means explicit subsidies less indirect taxes, calculated in real terms and divided by each sector's gross output. That measures a shift of resources to or from the sector. Mining is again ranked first, with a shift equivalent to ¼% of output to the sector. Oil and coal are ranked 13th, with an outward shift of 16%.

• **Trade protection.** This is based on an earlier study's estimates of the effective rate of protection in each industry—ie, the extent to which import tariffs and quotas raise domestic prices, relative to the value-added in each industry. Over the period, the processed-food industry was most protected, with an effective tariff of 45%. On this measure, mining was least preferred, with an effective tariff of minus 21% (meaning that the domestic price was lower than the international price).

• **Tax reliefs.** The authors calculated receipts of corporate taxes and divided them by profits (ie, by taxable income). The extent to which this ratio deviates from the aggregate rate of tax gives a measure of the sector's tax shelters. For the third time, mining was ranked most-preferred. Pulp and paper were ranked 13th.

And the winner is . . .

The table shows the results of this number-crunching. Two conclusions emerge. The first is that Japan's policy was a mess.

Many sectors received high rates of support on some measures and low rates on others. Mining received lots of cheap loans, transfers and tax relief, but fared worst on trade protection (probably because Japan, which lacks natural resources, was obliged to import most of its raw materials). But other sectors look odd, too. Textiles, for example, received lots of trade protection, transfers and tax breaks, but little cheap credit.

The other, and more important, finding is that Japanese industrial policy did not pick winners. In fact, as the authors show, if you calculate the correlation between growth in each sector and the support provided by the various industrial-policy instruments, you get a negative correlation in every case: minus 0.3 for cheap credit, minus 0.1 for transfers, minus 0.3 for trade protection and minus 0.6 for tax reliefs. In other words, support was given on the whole to slow-growth industries.

Much as in Europe, Japan's clever technocrats picked and supported losers. That the economy succeeded for decades is plain enough. But, on this evidence, industrial policy may well have hindered rather than advanced the cause.

*"Growth, Economies of Scale, and Targeting in Japan (1955-90)." Harvard Institute of Economic Research, Discussion Paper 1644.